

Message Text

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C O N F I D E N T I A L SECTION 1 OF 3 BUENOS AIRES 8130

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SUBJECT: YEAR-END ECONOMIC OVERVIEW

PASS TREASURY, COMMERCE, EXIMBANK

ARA: FOR DEPUTY ASSISTANT SECRETARY BRAY

1. SUMMARY AND INTRODUCTION.

AS YEAR-END APPROACHES, THE EMBASSY HAS SENSED INCREASED ECONOMIC MALAISE. THE MINISTER OF ECONOMY MARTINEZ DE HOZ, WHO IS THE ARCHITECT OF THE CURRENT ECONOMIC STRATEGY FOR ARGENTINA, IS CIMING UNDER INCREASING CRITICISM. THE STABILIZATION PROGRAM IS CREATING STRAINS AND PRESSURES ON THE VARIOUS SEGMENTS OF THE POPULATION AS ARTIFICIAL PRICE DISTORTIONS FAVORING VESTED INTERESTS ARE REDUCED AND INCOME REDISTRIBUTED. AS A RESULT, THE ECONOMIC PROGNOSIS FOR ARGENTINA HAS BECOME INEVITABLY LINKED WITH ASSESSMENTS ON HOW LONG MINISTER MARTINEZ DE HOZ WILL BE ABLE TO WITHSTAND PRESSURES AND REMAIN IN OFFICE. IF HE DOES NOT HAVE TO COMPROMISE TOO MUCH OR LEAVE OFFICE BEFORE THE MIDDLE OF 1977, THE PROGNOSIS IS GENERALLY GOOD; IF HE DOES, ARGENTINA COULD WELL LOSE ALL THE GAINS MADE THUS FAR.

2. WHILE THE RECENT HISTORY OF ARGENTINA SHOULD LEAD ONE TO BE PESSIMISTIC, THE ECONOMIC ANALYSIS IN THIS REPORT ASSUMES CONTINUITY OF THE PRESENT ECONOMIC LEADERSHIP AND DIRECTION. IN THE INTERNAL SECTOR, MANY PROBLEMS STILL HAVE TO BE OVERCOME: THE ECONOMY REMAINS SLUGGISH, SUFFERING FROM REDUCED AGGREGATE DEMAND;

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AGRICULTURE RESONDED TO GOA INCENTIVES BY PRODUCING A RECORD WHEAT CROP WHICH NOW FACES A SHARP DECLINE IN INTERNATIONAL PRICES,

DEFICIT STORAGE CAPACITY, AND MARKETING PROBLEMS; INFLATION REMAINS AT A HIGH LEVEL; REAL WAGES CONTINUE TO DECLINE, LEADING TO LABOR UNREST; THE BUDGET DEFICIT HAS BEEN INCREASING; AND THE GOA'S LEGISLATIVE PROGRAM TO ENCOURAGE PRIVATE INVESTMENT, AND IN PARTICULAR FOREIGN INVESTMENT, APPEARS TO BE STALLED. DESPITE ALL THESE PROBLEMS, THE OUTLOOK IS FOR A SLOW BUT STEADY RECOVERY IN 1977 AS INVESTMENT IN BOTH THE PRIVATE AND PUBLIC SECTORS BEGIN TO STIMULATE ECONOMIC ACTIVITY.

3. IN THE EXTERNAL SECTOR, THE GOA'S ACHIEVEMENTS HAVE BEEN MOST NOTABLE; SUCCESS IN OBTAINING CREDITS, REDUCING ARGENTINA'S SHORT-TERM DEBT, REPLENISHING FOREIGN EXCHANGE RESERVES, UNIFYING ARGENTINA'S FOREIGN EXCHANGE RATE, AND A SURPLUS IN THE MERCHANDISE BALANCE OF TRADE. THE FAVORABLE TRENDS ARE EXPECTED TO CONTINUE IN 1977.

4. DESPITE THE DIFFICULTIES ENCOUNTERED BY CURRENT ECONOMIC POLICIES, THE MARTINEZ DE HOZ-VIDELA GRADUALIST FREE MARKET ORIENTATION APPEARS TO BE THE BEST HOPE FOR ARGENTINA TO BREAK AWAY FROM ITS INEFFICIENT, STATIST, PROTECTIONIST STRAITJACKET. SHOULD MARTINEZ DE HOZ BE REMOVED SOON FOR ANY REASON, CONFIDENCE IN THE REGIME WOULD BE HURT AND ARGENTINA'S ABILITY TO OBTAIN NEW INTERNATIONAL CREDITS AND TO ATTRACT INVESTMENT LIMITED. DURING THIS CRITICAL PERIOD IN WHICH CONFIDENCE IS SO IMPORTANT, THE APPLICATION OF THE HARKIN AMENDMENT AND CUTTING OF FMS SALES BY THE US COULD SIMILARLY HURT THE CURRENT GOVERNMENT'S INTERNATIONAL STANDING AND CREDIT-WORTHINESS. THE RESULTING BLOW TO ARGENTINA'S PRESTIGE MIGHT STRENGTHEN THE HANDS OF THE NATIONALIST "HARDLINERS" AT THE EXPENSE OF VIDELA MODERATES, AND IF THEY GAINED POWER, LEAD ARGENTINA INTO AUTARKIC, ANTI-FOREIGN INVESTMENT POLICIES HURTING US ECONOMIC INTERESTS IN ARGENTINA.

5. AN UNCLASSIFIED VARIATION OF THIS REPORT IS BEING POUCHED IN COMPLIANCE WITH CERP 0004 -- ECONOMIC TRENDS REPORT.

6. INTERNAL SECTOR. THE ARGENTINE ECONOMY REMAINS SLUGGISH, WITH 1976 GDP CALCULATED AT ABOUT 3 PERCENT BELOW THE LEVEL OF 1975 -- A YEAR WHICH ALSO HAD A NEGATIVE GROWTH RATE (-1.4 PERCENT). WITH SUPPRESSED WAGES AND AN AUSTERE BUDGET CONTINUING
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TO HOLD DOWN AGGREGATE DEMAND, THE RECOVERY IN 1977 IS EXPECTED TO BEGIN SLOWLY IN THE FIRST SEMESTER AND INCREASE MOMENTUM IN THE SECOND SEMESTER AS INVESTMENT IN BOTH THE PRIVATE AND PUBLIC SECTORS (LATTER WITH INTERNATIONAL FINANCING) BEGIN TO STIMULATE ECONOMIC ACTIVITY. OFFICIAL SOURCES ESTIMATE 1977 GDP GROWTH AT 5 PERCENT-- WHICH IF ACHIEVED WILL BRING ECONOMIC ACTIVITY BACK TO THE LEVEL OF 1974.

7. RESPONDING TO THE FREE MARKET ORIENTATION OF NEW GOVERNMENT AND HIGHER SUPPORT PRICES, AGRICULTURE IN 1976/77 PRODUCED

A RECORD WHEAT CROP OF AT LEAST 12 MILLION TONS. UNFORTUNATELY, THE SHARP DECLINE INTERNATIONAL WHEAT PRICES WILL REDUCE THE STIMULATIVE EFFECT THE HARVEST COULD HAVE HAD ON THE ECONOMY AND DISCOURAGE WHEAT PLANTING IN 1977. ARGENTINA NEEDS TO MOVE ITS CURRENT WHEAT CROP RAPIDLY BECAUSE ITS DEFICIENT STORAGE FACILITIES (ABOUT 50 PERCENT OF GRAIN/OILSEED HARVEST) WILL BE NEED FOR CORN AND GRAIN SORGHUM. THE OUTLOOK FOR MEAT, ON THE OTHER HAND, IS GOOD. ARGENTINA WAS ABLE TO FIND NEW MARKET OUTLETS FOR ITS MEAT IN 1976 WHICH COMPENSATED PARTIALLY FOR THE CONTINUING LIMITATION ON IMPORTS BY THE EC. IN 1977, AS THE EC MARKET IS EXPECTED TO BEGIN TO OPEN UP MORE TO ARGENTINE MEAT IMPORTS AND IF PRICES RISE AS EXPECTED, ARGENTINA'S EXPORT EARNINGS FROM MEAT SHOULD INCREASE SUBSTANTIALLY.

8. THE INDUSTRIAL SECTOR'S ECONOMIC SITUATION IS UNEVEN. IN GENERAL, INDUSTRIES SERVING AGRICULTURE (E.G., TRACTORS, HEAVY UTILITY VEHICLES) OR PROCESSING AGRICULTURAL PRODUCTION FOR EXPORT (MEAT, CANNING, LEATHER) FARED MUCH BETTER IN 1976 THAN THOSE ORIENTED PRIMARILY TOWARD THE INTERNAL CONSUMER MARKET. THE LATTER AS A WHOLE SUFFERED FROM OVER-CAPACITY, EXCESS LABOR FORCE, REDUCED INTERNAL DEMAND, AND LACK OF COMPETITIVENESS ON THE INTERNATIONAL MARKETS (A PRIME EXAMPLE BEING THE ARGENTINE AUTOMOBILE INDUSTRY). IF THE GOVERNMENT PROCEEDS TO REMOVE PROTECTION FROM INDUSTRY AS IT HAS ANNOUNCED, THE LESS EFFICIENT INDUSTRIES WILL BE INCREASINGLY SQUEEZED -- PARTICULARLY IF THE LOCAL CONSUMER IS FORCED TO SPEND A GREATER SHARE OF HIS INCOME ON FOOD (SEE B.A. 7628).

9. CONSTRUCTION, WHICH IS IMPORTANT IN TERMS OF EMPLOYMENT, IS EXTREMELY DEPRESSED AS

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A RESULT OF BUDGETARY RESTRAINTS ON PUBLIC WORKS PROJECTS AND THE LIMITED AMOUNT OF FINANCING FOR PRIVATE HOUSING. THE SECTOR'S SITUATION IN 1977 SHOULD IMPROVE AS MAJOR PROJECTS WITH INTERNATIONAL FINANCING ARE IMPLEMENTED.

10. INFLATION STILL HIGH. THE GOA'S STABILIZATION PROGRAM SUCCEEDED IN PREVENTING A HYPERINFLATIONARY SITUATION FROM DEVELOPING. IN MARCH, THE COST OF LIVING INDEX ROSE 38 PERCENT (ANNUAL RATE OF 556 PERCENT). AFTER A DROP OF THE INFLATION RATE TO AN UNTENABLE 2.7 PERCENT/MONTH IN JUNE, INFLATION IN THE SEPTEMBER-NOVEMBER PERIOD HAS BEEN IN THE 8.0-10.6 PERCENT PER MONTH RANGE -- A LEVEL WHICH IS A CONSIDERABLE IMPROVEMENT OVER THE RATE REACHED IN MARCH. HOWEVER, THE INFLATION RATE IS STILL HIGH, PARTICULARLY TAKING INTO ACCOUNT THE LAGGING PACE OF WAGE ADJUSTMENTS. THE OVERALL RISE IN COST OF LIVING IN 1976 WILL BE AROUND 335 PERCENT -- ROUGHLY THE SAME AS IN 1975. PRIVATE SOURCES ESTIMATE THAT INFLATION IN 1977 WILL BE IN THE 100-120 PERCENT RANGE BUT THE GOA HOPES TO DO BETTER.

11. LABOR AND WAGE POLICY. THE GOA'S LABOR AND WAGE POLICY IS WITHOUT A DOUBT THE MOST POLITICALLY SENSITIVE AND POTENTIALLY DANGEROUS ASPECT OF THE CURRENT GOVERNMENT'S ECONOMIC PROGRAM. WITH A VIEW TOWARD PREVENTING UNEMPLOYMENT LEVELS FROM INCREASING LIMITED OFFICIAL USE
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SUBSTANTIALLY DURING THE RECESSION, THE GOA ADOPTED A WAGE CONTROL POLICY IN WHICH OFFICIALLY AUTHORIZED WAGE INCREASES HAVE LAGGED BEHIND INFLATION. AT THE SAME TIME, THE GOA HAS PERSUADED INDUSTRY TO KEEP A LARGER NUMBER OF EMPLOYEES ON THE ROLLS, ALBEIT WORKING LESS HOURS, THAN WOULD HAVE BEEN JUSTIFIED BY PRODUCTION LEVELS. THE RESULT HAS BEEN A SUBSTANTIAL DECLINE IN THE REAL INCOME OF LABOR, PARTICULARLY TAKING INTO ACCOUNT THE REDUCTION IN HOURS WORKED. ALTHOUGH OFFICIAL STATISTICS INDICATE A DROP IN THE CONTRACT WAGE OF AROUND 50 PERCENT SINCE THE BEGINNING OF THE YEAR, THE REAL WAGE DECLINE IS SOMEWHAT LESS BECAUSE THE STATISTICS DO NOT TAKE INTO ACCOUNT NON-CONTRACT WAGE REMUNERATION OR ILLEGAL SALARY INCREASES THROUGH SUCH GIMMICKS AS "PROMOTIONS," NON-REIMBURSABLE LOANS, ETC. ON THE OTHER HAND, THE LEVEL OF UNEMPLOYMENT HAS REMAINED RELATIVELY LOW (4-5 PERCENT ACCORDING TO OFFICIAL SOURCES), PARTICULARLY CONSIDERING THE EXTENT OF THE RECESSION.

12. THE GOA'S LABOR POLICY HAS LED TO SOME LABOR UNREST, PARTICULARLY AMONG WORKERS BELONGING TO UNIONS WHICH WERE STRONG UNDER THE PERONIST PERIOD AND ARE NOW FACED WITH THE LOSS OF THEIR PRIVILEGED POSITION. THE GOA HAS ABROGATED SOME OF THESE PRIVILEGES UNILATERALLY AND, IN NOVEMBER, ANNOUNCED DIFFERENTIAL WAGE INCREASES GIVING MORE TO THOSE SEGMENTS OF LABOR WHICH WERE RELATIVELY DISADVANTAGED DURIN THE PERONIST ERA. A GENERAL WAGE INCREASE IS PROJECTED FOR JANUARY, 1977 -- BUT THE AMOUNT HAS NOT YET BEEN OFFICIALLY DETERMINED. THE GOA'S PRIMARY CONCERN IS TO AVOID EXCESSIVE WAGE INCREASES WHICH WILL REKINDLE THE STILL HIGH RATE OF INFLATION.

13. BUDGET DEFICIT INCREASING. THE GOA'S HUGE DEFICIT CONTINUES TO BE ARGENTINA'S ACHILLES HEEL. WHILE THERE HAS BEEN SOME PROGRESS IN KEEPING DOWN THE OVERALL LEVEL OF EXPENDITURES (PRIMARILY BY LIMITING WAGE INCREASES), TAX REVENUE HAS FAILED TO MEET EXPECTATIONS TO AN EVEN GREATER EXTENT (LARGE SHORFALLS HAVE BEEN REGISTERED IN THE FUEL, EXPORT, IMPORT, STAMP, AND UNIFIED TAXES). AS A RESULT, AFTER AN AUSPICIOUS SECOND QUARTER IN WHICH THE BUDGET LIMITED OFFICIAL USE
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DEFICIT/EXPENDITURE PERCENTAGES DECREASED GRADUALLY, THE TREND REVERSED ITSELF IN JULY AND REACHED 65 PERCENT IN OCTOBER (WHICH MEANS THAT REGULAR SOURCES OF REVENUE WERE COVERING ONLY 35 PERCENT OF EXPENDITURES). STATISTICS SHOW THAT, DESPITE CATCHUP INCREASES IN THE RATES CHARGED BY STATE ENTERPRISES, TREASURY SUBSIDIES FOR THEM HAVE ACTUALLY RISEN AS A PERCENTAGE OF EXPENDITURES, FROM 17 PERCENT IN MARCH TO 23 PERCENT IN OCTOBER. MOREOVER, ALTHOUGH THE GOVERNMENT HAS BEEN SUCCESSFUL IN COVERING AN INCREASING AMOUNT OF THE DEFICIT BY PUBLIC BORROWING (IN OCTOBER BORROWING TOTALLED 55 BILLION PESOS, GREATLY EXCEEDING THE 36 BILLION PESOS OBTAINED FROM NORMAL SOURCES OF REVENUE), THE DEBT/SERVICE BURDEN ON THE BUDGET HAS RAPIDLY INCREASED AS WELL (IN MARCH WAS 7.4 PERCENT OF EXPENDITURES AND IN OCTOBER 17 PERCENT). IT IS THEREFORE APPARENT THAT THE GOA MUST DO SOMETHING TO ARREST OR REVERSE THESE TRENDS. MINISTER MARTINEZ DE HOZ, DURING A FIRESIDE CHAT ON TELEVISION, PLACED CONSIDERABLE HOPE THAT THE REORGANIZATION OF STATE ENTERPRISES INTO PUBLIC CORPORATIONS (THUS REQUIRING BALANCE SHEETS AND PRESUMABLY TIGHTER ACCOUNTING CONTROLS) WOULD DO MUCH TO REDUCE THE SUBSIDY BURDEN ON THE TREASURY. SECRETARY OF TREASURY ALEMANN, KNOWN FOR HIS BLUNTNESS, HAS REPORTEDLY INFORMED THE MILITARY LEADERS IN THE GOVERNMENT AND IN THE LEGISLATIVE ADVISORY COUNCIL (CAL) THAT, IF ARGENTINA IS TO MEET ITS IMF COMMITMENT TO REDUCE THE DEFICIT IN 1977 TO 3 PERCENT OF

GDP, THE GOVERNMENT IS GOING TO HAVE TO BITE THE BULLET AND REDUCE EXPENDITURES AND/OR INCREASE TAX REVENUE SUBSTANTIALLY. HE INDICATED THAT THERE WERE VARIOUS WAYS THE DEFICIT COULD BE REDUCED BUT, IN THE LAST ANALYSIS, THE MANNER CHOSEN IS A POLITICAL DECISION -- WHICH ONLY THE TOP GOA MILITARY LEADERS CAN MAKE. DESPITE THE LOGIC OF ALEMANN'S APPROACH, THE QUESTION STILL REMAINS WHETHER THE JUNTA HAS THE WILL TO IMPOSE UNPOPULAR, HARSH DECISIONS. THE GOA HAS ALREADY ANNOUNCED THAT THERE WILL BE GENERAL WAGE INCREASES IN JANUARY FOR CIVIL SERVANTS AND THAT THOSE IN EXECUTIVE LEVEL POSITIONS WILL RECEIVE A PROPORTIONATELY HIGHER RAISE. THESE INCREASED LIMITED OFFICIAL USE LIMITED OFFICIAL USE

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GOVERNMENT EXPENDITURES WILL REQUIRE COMPENSATORY MEASURES ON THE REVENUE SIDE. IN THE SHORT-RUN, DISMISSAL OF EXCESS EMPLOYEES WILL NOT ALLEVIATE THE SITUATION MUCH BECAUSE OF SEVERANCE PAYMENT REQUIREMENTS. THEREFORE, INCREASED TAXATION, EITHER THROUGH THE PROVINCIAL REAL ESTATE TAX, NATIONAL ASSETS TAX, OR IMPROVED COLLECTION, WILL BE NECESSARY TO REDUCE THE FISCAL IMBALANCE -- A SOLUTION WHICH WILL BE RESISTED BY THE ARGENTINES' TRADITIONAL AVERSION TO TAXES.

14. MONETARY POLICY SUCCEEDS IN MAINTAINING MODERATE MONETARY EXPANSION. THE GOA HAS SUCCEEDED IN MAINTAINING THE EXPANSION OF THE MONEY SUPPLY AT MODERATE LEVELS BY SELLING ADJUSTABLE GOVERNMENT BONDS AND TREASURY BILLS TO ABSORB MUCH OF THE MONETARY EXPANSION WHICH WOULD HAVE BEEN CAUSED BY THE BUDGET DEFICIT. THE

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GOA HAS ALSO NEUTRALIZED THE MONEY EXPANSION WHICH TRADITIONALLY RESULTED FROM RENEWAL OF SWAP OPERATIONS BY: A) KEEPING SWAP EXCHANGE RATE FIXED AT 140 PESOS/DOLLAR; AND B) REDUCING THE OVERALL LEVEL OF ARGENTINA'S SWAP LIABILITIES. AS A RESULT, THE MONEY SUPPLY EXPANSION IN SEPTEMBER (8.1 PERCENT) AND IN OCTOBER (8.4 PERCENT) WAS BELOW THE RATE OF INFLATION.

15. KEY ECONOMIC LEGISLATION STALLED. THE DELAY IN APPROVAL OF KEY ECONOMIC LEGISLATION AND REGULATIONS AND IN SETTLING OUTSTANDING FOREIGN INVESTMENT DISPUTES IS RAISING SOME DOUBTS ABOUT THE GOA'S ABILITY TO MAINTAIN ITS FREE MARKET, PRO-FOREIGN INVESTMENT ORIENTATION. SOURCES ATTRIBUTE THE DELAY BOTH TO THE INEXPERIENCE OF THE MILITARY IN THE NATIONAL ADMINISTRATION AND IN THE LEGISLATIVE ADVISORY COUNCIL (CAL) AND TO THE OPPOSITION OF NATIONALIST, STATIST FORCES. A DRAFT OF THE REGULATIONS TO THE NEW FOREIGN NIVESTMENT LAW APPROVED LAST AUGUST HAS BEEN CIRCULATING FOR A COUPLE OF MONTHS AND IS CURRENTLY BEING REVIEWED IN THE PRESIDENCY. IN A SIMILAR STATE OF SUSPENSION ARE BILLS FOR NEW LEGISLATION ON TRANSFER OF TECHNOLOGY, INDUSTRIAL PROMOTION, MINING, AND BANKING. NATIONALIST FORCES ARE REPORTEDLY PARTICULARLY OPPOSED TO THE BANKING LAW AS CURRENTLY DRAFTED BECAUSE IT ELIMINATES MUCH OF THE DISCRIMINATION AGAINST FOREIGN-OWNED BANKS. THE BANKING LAW, THEREFORE, APPEARS TO HAVE VIRTUALLY NO CHANCE OF BEING APPROVED IN ITS PRESENT FORM.
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SIMILARLY, NATIONALIST SENTIMENTS OF SOME OF THE MEMBERS OF THE COMMISSIONS STUDYING THE FOREIGN INVESTMENTS DISPUTES ARE REPORTEDLY DELAYING SETTLEMENTS WITH THE PETROLEUM COMPANIES AND BANKS.

16. EXTERNAL SECTOR REGISTERS SUCCESSES. MARTINEZ DE HOZ'S ACHIEVEMENTS IN THE EXTERNAL SECTOR HAVE BEEN REMARKABLE. AMONG THEM ARE:
A) \$1.3 BILLION IN FINANCIAL CREDITS, INCLUDING \$300 MILLION FROM THE IMF AND \$1 BILLION FROM PRIVATE COMMERCIAL BANKS. THE PRIVATE CREDITS HAVE A TERM OF FOUR YEARS (INCLUDING ONE YEAR OF GRACE) AND WILL ENABLE ARGENTINA TO MEET ITS SHORT-TERM DEBT LIABILITIES AND EXTEND THE OVERALL MATURITY OF ITS EXTERNAL DEBT.

B) \$262 MILLION IN APPROVED PROJECT LOANS FROM THE IBRD AND IDB FOR ELECTRIC POWER, A GAS PIPELINE, AND SILOS. OTHER PROJECT LOAN REQUESTS ARE IN AN ADVANCED STAGE OF CONSIDERATION BY THE IBRD AND IDB. WHEN THESE PROJECTS BEGIN TO BE IMPLEMENTED (PROBABLY SECOND HALF OF 1977), THEY SHOULD HAVE A BENEFICIAL IMPACT ON THE ARGENTINE ECONOMY.

C) REDUCTION OF ARGENTINA'S SHORT-TERM SWAP DEBT FROM \$1.3 BILLION IN JUNE 1976 TO \$840 MILLION BY THE END OF OCTOBER 1976. THE GOA COMMITTED ITSELF TO REDUCE THE SWAP LEVEL TO \$600 MILLION BY THE END OF THE YEAR AND THE OUTLOOK IS GOOD THAT IT WILL REACH THIS GOAL.

D) AT THE END OF SEPTEMBER, 1976, ARGENTINA'S GROSS RESERVES STOOD AT ROUGHLY \$1.5 BILLION -- A CONSIDERABLE IMPROVEMENT OVER THE \$845 MILLION LEVEL AT THE BEGINNING OF THE YEAR. DESPITE HEAVY REPAYMENTS OF SHORT-TERM DEBT, GROSS RESERVES ARE EXPECTED TO REACH AT LEAST \$1.6 BILLION BY YEAR-END.

E) WITH EXCEPTION OF THE EXCHANGE RATE USED FOR SWAP OPERATIONS (140 PESOS/DOLLAR), THE GOA HAS UNIFIED THE EXCHANGE RATE FOR ALL TRANSACTIONS, REDUCING SOME OF THE ECONOMIC DISTORTIONS CAUSED BY DIFFERENTIAL RATES (DISTORTIONS STILL EXIST BECAUSE OF THE COMPLEX SYSTEM OF DIFFERENTIAL TAXES AND SUBSIDIES IN FORCE).

F) THE BALANCE OF PAYMENTS SITUATION HAS IMPROVED
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DRAMATICALLY. A SURPLUS OF AROUND \$800 MILLION IS EXPECTED ON THE MERCHANDISE ACCOUNT (EXPORTS OF \$3.8 BILLION AND IMPORTS OF \$3 BILLION), AS WELL AS A SMALLER THAN USUAL DEFICIT IN SERVICES. WHILE SOME OF THE IMPROVEMENT CAN BE ATTRIBUTABLE TO THE EFFECTS OF THE RECESSION ON EXPORTS AND IMPORTS, THERE IS NO DOUBT THAT ADROIT HANDLING OF THE EXCHANGE RATE AND INTERNAL INTEREST RATES ALSO HAD AN IMPORTANT IMPACT -- PARTICULARLY IN ENCOURAGING THE RETURN OF CAPITAL BELONGING TO ARGENTINES (EFFECT IS SEEN PRIMARILY IN GROWTH OF "TOURIST" RECEIPTS). THE BALANCE OF PAYMENTS OUTLOOK FOR 1977 IS ALSO ENCOURAGING. BOOSTED BY INCREASED EARNINGS FROM CEREAL AND ANIMAL PRODUCTS, EXPORT REVENUES ARE EXPECTED TO RACH AT LEAST \$4.3 BILLION -- MORE THAN COVERING THE \$3.8 BILLION EXPECTED IN IMPORTS AS THE ECONOMY RECOVERS.

17. POLICY IMPLICATIONS. DESPITE THE DIFFICULTIES ENCOUNTERED BY CURRENT ECONOMIC POLICIES, THE MARTINEZ DE HOZ-VIDELA GRADUALIST FREE MARKET ORIENTATION APPEARS TO BE THE BEST HOPE FOR ARGENTINA TO BREAK AWAY FROM ITS INEFFICIENT, STATIST PROTECTIONIST

STRAIT JACKET. THE OTHER TWO MAIN ALTERNATIVES ARE: A) A SHOCK, FREE MARKET POLICY PROPOSED BY EX-ECONOMIC MINISTER ALVARO ALSOGARAY -- A POLICY WHICH WOULD ELIMINATE WAGE CONTROLS BUT ALSO NOT MAINTAIN EMPLOYMENT LEVELS BEYOND THAT REQUIRED FOR EFFICIENT PRODUCTION. THE RESULTING INCREASE IN UNEMPLOYMENT WOULD PROBABLY BE POLITICALLY UNTENABLE; AND B) A STATIS, PROTECTIONIST POLICY WHICH WOULD IN EFFECT MAINTAIN THE STATUS QUO. SHOULD MARTINES DE HOZ BE REMOVED FOR ANY REASON, THERE IS NO DOUBT THAT IT WOULD HURT CONFIDENCE IN THE REGIME AND LIMIT ARGENTINA'S ABILITY TO OBTAIN NEW INTERNATIONAL CREDITS AND ATTRACT INVESTMENT. EVEN SOME OPPONENTS OF MARTINEZ DE HOZ'S POLICIES RECOGNIZE THE IMPORTANCE OF CONTINUITY OF LEADERSHIP AT THIS STAGE OF ARGENTINA'S HISTORY AND THEREFORE PUT MORE EMPHASIS ON CHANGING THE DIRECTION OF HIS POLICIES THAN ON REMOVING HIM.

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18. IN THIS CRITICAL PERIOD, U.S. POLITICAL AND ECONOMIC POLICIES ARE OF IMPORTANCE TO ARGENTINA. WHILE THE INVOKING OF THE HARKIN AMEDMENT OR CUTTING OFF OF FMS SALES WOULD PROBABLY HAVE A MINIMAL DIRECT IMPACT ON ARGENTINA'S ABILITY TO OBTAIN CREDIT FROM THE IDB OR MILITARY SUPPLIES FROM OTHER SOURCES, THE INDIRECT EFFECT ON ARGENTINA'S POLITICAL IMAGE COULD HURT ITS ABILITY TO RAISE CREDITS ABROAD. SOME US BANKERS HAVE STATED PRIVATELY THEIR BANKS MIGHT FIND IT DIFFICULT FROM A PUBLIC RELATIONS POINT OF VIEW TO INCREASE THEIR EXPOSURE IN ARGENTINA SHOULD THE HARKIN AMENDMENT BE APPLIED. SINCE THE U.S. BANKS HAD TO AKE THE LEAD IN THE RECENT ROUND OF \$1 BILLION IN COMMERCIAL CREDITS FOR ARGENTINA, THE EFFECT COULD ALSO SPILL OVER INTO CREDITS FROM OTHER COUNTRIES. THE RESULTING BLOW TO ARGENTINA'S PRIDE COULD STRENGTHEN THE HANDS OF THE NATIONALIST "HARDLINERS" AT THE EXPENSE OF THE VIDELA MODERATES AND, IF THEY GAINED POWER, LEAD ARGENTINE INTO AUTARKIC, ANTI-FOREIGN INVESTMENT POLICIES HURTING U.S. ECONOMIC INTERESTS, INCLUDING: \$1.2 BILLION IN DIRECT INVESTMENT AND A MARKET FOR U.S. EXPORTS (TOTAL OF \$638 MILLION IN 1975).
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Subject: YEAR-END ECONOMIC OVERVIEW PASS TREASURY, COMMERCE, EXIMBANK ARA: FOR DEPUTY ASSISTANT SECRETARY BRAY
TAGS: EGEN, PINT, ELAB, EINV, EFIN, AR
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